No. 14258.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GLENS FALLS INDEMNITY COMPANY, a New York corporation, and E. F. GRANDY, INC., a California corporation,

Appellants,

vs.

AMERICAN SEATING COMPANY, a New Jersey corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

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TOPICAL INDEX

PAGE

V.

VI.

PAGE

VII.

TABLE OF AUTHORITIES CITED

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I.

Statement of the Pleadings and Facts Disclosing Jurisdiction.

Pleadings consist of the Complaint, the Answer of Glens Falls Indemnity Company and the Answer of Defendant E. F. Grandy, Inc. Jurisdiction is based upon diversity of citizenship. Plaintiff American Seating Company is a New Jersey corporation, defendant Glens Falls Indemnity Company is a New York corporation and defendant E. F. Grandy, Inc., is a California corporation [R. 3]. The Farmers and Merchants Bank of Long Beach, which is also a defendant, but not an appellant, is a California corporation [R. 4].

The amount in controversy exceeds the sum of $3,000.00, exclusive of interest and costs, to wit, the sum of $6,124.37 [R. 9]. Jurisdiction of the District Court of the United States is authorized by Title 28, U. S. C., Section 1332. Jurisdiction of the United States Court of Appeals is based upon Title 28, U. S. C., Section 1291.

II.

The Nature of the Proceedings in the Trial Court.

For convenience appellant Glens Falls Indemnity Company, a corporation, one of the defendants in the trial court, will be referred to as Glens Falls, and appellant E. F. Grandy, Inc., a corporation, one of the defendants in the trial court, will be referred to as Grandy, Inc. The Farmers and Merchants Bank of Long Beach was also a defendant in the trial court, but trial as to this defendant was deferred pending judgment as to the other parties [R. 33, 99]. Appellee American Seating Company, a corporation, was plaintiff in the trial court.

On April 1, 1953, at the pre-trial conference, the parties filed pre-trial briefs, each of which contained a statement of facts. Counsel for appellants Glens Falls and Grandy, Inc., objected to including conclusions in the statement of facts contained in the pre-trial brief of plaintiff and appellee American Seating Company. Rather than debate the specific wording of his statement of facts, counsel for American Seating Company undertook to orally make a statement of facts and to introduce exhibits for identification. For this reason the statement of facts contained in the pre-trial brief of plaintiff American Seating Company has not been included in the printed transcript, while those of the defendants have been included [R. 28, 30].

The statement of facts of Glens Falls and Grandy, Inc., was amended [R. 95] by deleting the following words, commencing in the second line on page 31 of the record:

> "to protect it, E. F. Grandy, Inc., in the event it suffered a loss by reason of the subcontract,"

and by substituting the figures "16,667.05" for the words "in full" appearing at line 12 of page 31 of the record. The statement as amended was conceded to be correct [R. 96]. These amendments were made to avoid conclusions, but the contentions of the appellants are unchanged by the amendments.

The evidence includes the oral statement of facts of counsel for American Seating Company and the written statement of the other parties, the admissions and answers to interrogatories [R. 108], and the exhibits. All of the exhibits are printed in the record except Exhibit B, which is a Government construction contract too lengthy to be printed.

While counsel for appellee was making his statement of facts there was some discussion concerning whether or not there was a telephone call from a representative of appellee to a representative of appellant Glens Falls on or about December 1, 1950 [R. 86, 90], but any issue with respect to this telephone call was withdrawn [R. 105].

The transcript of the proceedings at the pre-trial conference which took place on April 1, 1953, was a transcript consisting principally of the opening statement of counsel for American Seating Company and identification of exhibits and objections to the introduction thereof. The case was then set for trial on May 8, 1953, at which time it was contemplated that the case would be argued after

objections to introduction of exhibits had been settled. On May 8, 1953, certain corrections were made in some of the answers to interrogatories, some of the objections to introduction of exhibits were ruled upon and additional exhibits were admitted while the objections to the introduction of other exhibits were taken under submission.

There was no ruling upon objections taken under submission until after appellants had moved in this court to clarify the record on appeal by striking from the record Exhibits 1, 9, 10 and 11, which had been admitted for identification only. On the date of the hearing of said motion before the United States Court of Appeals on the 5th day of April, 1954, counsel for American Seating Company presented an Order Ex Parte Nunc Pro Tunc to June 1, 1953, receiving said exhibits in evidence, appended to which order was a statement reciting that it was an inadvertence that said exhibits had not been received in evidence. It was thereupon stipulated that the trial court had overruled objections to the admission of any of the exhibits originally offered for identification.

At the trial on May 8, 1953, no witnesses were sworn and no oral testimony was taken. But after the matter of introduction of exhibits and other incidental matters had been concluded, counsel for American Seating Company made a brief argument and the court ordered the case submitted upon briefs to be filed.

III.

Statement of Facts.

On or about the 29th day of April, 1949, defendant E. F. Grandy, Inc., as prime contractor, entered into a written contract in the sum of $100,315.00 with the United States Government for the construction of certain work at the United States Naval Ammunition and Net Depot at Seal Beach, California, and posted with the United States Government a performance bond and a labor and materials bond, as required by the Miller Act, 40 U. S. C. A. 270a and 270b [R. 30]. By an instrument dated the 4th day of May, 1949, defendant Grandy, Inc., entered into a written subcontract in the sum of $16,667.05 with one V. L. Murphy, a plumbing contractor, to do a portion of the work required by the prime contract with the United States Government [R. 147].

On May 12, 1949, Grandy, Inc. replied [by Ex. 1, R. 146] to a letter (which is not in evidence) from its subcontractor, V. L. Murphy. This letter explained the position of Grandy, Inc., relative to "demand payments" to its subcontractors and suggested a way for V. L. Murphy to obtain additional operating capital if such was required. Quoting Exhibit 1 [R. 147]:

> "I might recommend, should additional operating capital be required, that this sub-contract may be assigned to the Bank with whom you are regularly depositing."

It is apparent from the foregoing that prior to May 12, 1949, the subcontract, as it appears in the record, had not

been completely filled out. It would appear that the clause referred to in the letter of May 12 as added is the paragraph appearing in the record as the last paragraph on page 148 of the record. The reason for the subcontractor's inquiry and the contractor's suggestion relative to financing is apparent from the fact that only a few days later, on May 23, 1949, V. L. Murphy was indebted to The Farmers and Merchants Bank of Long Beach for loans and advances in the amount of $10,000.00 and needed further loans [R. 29].

The subcontract was not complete in another respect. It provided that the subcontractor, at his expense, should furnish "a performance or completion bond" with sureties satisfactory to the subcontractor [R. 150]. Performance of this requirement varied somewhat from the precise requirement of the contract in that the contractor and the subcontractor agreed that the subcontractor, V. L. Murphy, would furnish a performance bond in the sum of $16,667.05, and also a payment bond in the principal sum of one-half or $8,333.58 [R. 72-73]. Pursuant to this agreement, both of these bonds were furnished and accepted on May 18, 1949, with appellant Glens Falls as surety [Ex. 3, R. 153; Ex. 4, R. 155].

On May 23, 1949, the subcontractor acted upon the suggestion of the contractor relative to financing. He assigned the subcontract to The Farmers and Merchants Bank of Long Beach [Ex. 16, R. 171]. The contractor, Grandy, Inc., consented in writing to the assignment on

the same day [Ex. 15, R. 170; see also Interrogatory 33, R. 23]. At the time of this assignment, V. L. Murphy was indebted to The Farmers and Merchants Bank of Long Beach for loans and advances in the sum of $10,000.00 and thereafter the bank loaned V. L. Murphy in excess of $46,000.00 [R. 29].

American Seating Company addressed a letter [Ex. 6, R. 158], dated August 23, 1949, to V. L. Murphy, plumbing contractor, and sent a copy of it to Mr. Grandy, who was president of Grandy, Inc., the prime contractor. American Seating Company's purpose in sending this copy to Mr. Grandy is expressed in the first paragraph of the letter in these words:

> "so that he will be acquainted with what has transpired verbally for the last two months."

This letter bears a stamp reading, "Received August 25, 1949 E. F. Grandy, Inc." The letter commences by saying:

> "We are enclosing a copy of our revised quotation on equipment for the above mentioned laboratory."

There is no evidence that a copy of such revised quotation was included with the copy of American Seating Company's August 23, 1949, letter. The revised quotation referred to is probably Exhibit 5 [R. 156].

The evidence indicates that Exhibit 5 was received by Grandy, Inc., on September 24, 1949, and notwithstanding the fact that it was addressed "To all contractors" and dated August 22, 1949, there is no evidence that it was transmitted to Grandy, Inc., before September 24, 1949.

On this same date, September 24, 1949, Grandy, Inc., received a copy of a purchase order, Exhibit 7 [R. 161]. The original of this order was sent to the addressee thereof, American Seating Company, by V. L. Murphy, the subcontractor [R. 81]. Only a copy was sent to Grandy, Inc. [R. 82]. It may be significant to note that the copy of the revised quotation, Exhibit 5, and the copy of the purchase order, Exhibit 7, were received by Grandy, Inc., on the same day. There is no evidence of a transmittal letter accompanying either of these exhibits, nor is there any evidence which specifies the reason for sending these copies to Grandy, Inc.

By letter dated September 26, 1949 [Ex. 8, R. 163], Grandy, Inc., forwarded to the Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, at Long Beach, California, four copies of the purchase order issued by V. L. Murphy to American Seating Company. The full text of the lettter is as follows:

> "1. Enclosed herewith four (4) copies Purchase Order from V. L. Murphy, plumbing sub-contractor, to American Seating Company, agents for Kewaunee Manufacturing Company for chemical laboratory equipment presently being manufactured at Adrian, Michigan.
>
> "2. It is requested that the Officer-in-Charge of Construction do everything possible to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation."

On December 20, 1949, American Seating Company wrote to Mr. E. F. Grandy, president of Grandy, Inc., advising that three items of the equipment being furnished

by American Seating Company were being corrected [Ex. 9, R. 164]. On December 22, 1949, Grandy, Inc., wrote to Officer-in-Charge of Construction, Attention: Contract Superintendent, enclosing three copies of certain correspondence received from American Seating Company [Ex. 10, R. 165], but the enclosures are not identified or attached to the exhibit and there is no evidence as to what may have been enclosed. The purpose for which this document, and apparently others, was introduced appears in the record at page 126. Counsel for appellee stated:

> "The purpose of these documents is to show the notice that E. F. Grandy had of the fact that American Seating Company was the supplier of material to its subcontractor in connection with this work, something counsel has attempted to deny and admit in various forms."

On January 6, 1950, Grandy, Inc., wrote to American Seating Company enclosing a copy of a letter received by Grandy, Inc., from the Officer-in-Charge of Construction relative to non-compliance with specific requirements (which enclosure does not appear in the record) saying [Ex. 11, R. 165-170]:

> "You are, no doubt, aware that the above mentioned noncompliance constitutes a very effective block to receipt of funds for work already performed in the contract at Seal Beach.
>
> "In view of this condition, it is requested that your firm make all possible effort to comply with the required work outlined in the enclosed letter."

American Seating Company invoiced V. L. Murphy for $6,124.37, including 3% State Sales Tax, by invoice dated March 15, 1950. The invoice appears in the record as an

enclosure to Exhibit 12 at page 168 and reads in part as follows:

> "No. 58706 OR/CO Date: 3-15-50
>
> Sold to: V. L. Murphy, Plumbing & Heating, Mr. V. L. Murphy, Box 214A, Route 1, Anaheim, California.
>
> Ship to: Quality Control Surveillance Laboratory, U. S. Naval Ammunition and Net Depot, Seal Beach, California
>
> Date Entered: 6-27-49; Ship when: S.A.P.; Routing: Best way ppd; F.O.B.: Dest set up (not connected); Salesman: Mullen; Cust. No. 179. Terms: Net 30 days from date of invoice."

There are no other exhibits which are dated prior to completion of the contract.

Performance under the prime and subcontracts was completed and accepted by the United States in June of 1950 [R. 19, 31, 84, 102, 173]. Grandy, Inc., was paid in full [R. 76, 84]. Grandy, Inc., in turn paid V. L. Murphy in full by honoring the assignment to The Farmers and Merchants Bank of Long Beach [R. 31, 89] and the said bank credited the amount received on the indebtedness due it from V. L. Murphy [R. 29]. The final payment was made by Grandy, Inc., on July 17, 1950 [R. 89]. But V. L. Murphy did not pay American Seating Company.

The next action disclosed by the record is a letter addressed to Glens Falls by American Seating Company demanding payment under the payment bond. This letter is dated December 1, 1950, and is Exhibit 12 [R. 166]. At the pre-trial hearing counsel for American Seating

Company stated that a copy of this letter was also sent to Grandy, Inc. [R. 85]. There is nothing in the record other than the aforementioned statement of counsel to show that American Seating Company ever notified Grandy, Inc., that American Seating Company had not been paid and there is no evidence that American Seating Company ever made a demand upon Grandy, Inc., for payment.

On December 22, 1950, American Seating Company wrote another letter to Glens Falls requesting a written reply to the December 1, 1950, letter. This is in the record as Exhibit A [R. 174]. On January 3, 1951, Glens Falls replied to American Seating Company's demand against Glens Falls dated December 1, 1950 [Ex. 12, R. 166] and denied liability [Ex. 13, R. 169]. The only other exhibits which were introduced were Exhibit 17 [R. 172] and Exhibit C [R. 176]. These exhibits relate to the interrogatories and will be mentioned later.

On or about February 9, 1951, American Seating Company filed suit against V. L. Murphy in the Superior Court of Los Angeles County, case No. 582,886, and was awarded judgment on the 6th day of March, 1952, in the sum of $6,681.78 for the same materials which are the subject matter of this action [R. 31, 86]. According to the statement of counsel for American Seating Company, this judgment has never been collected and it is uncollectible because V. L. Murphy is insolvent [R. 86]. On July 2, 1952, American Seating Company instituted the instant action.

All of the allegations of the complaint [R. 3-9] and the invoice of American Seating Company [R. 168] show that the demand of American Seating Company is the

sum of $6,124.37. Both counsel understood and agreed that this was the amount in controversy [R. 76, 96]. However, in the answer of Grandy, Inc., to interrogatory No. 4 propounded by American Seating Company, there was an obvious typographical error [R. 18]. Instead of the figure $6,124.37, the answer contained the figure $61.37. It is apparent to anyone that two digits had been omitted, to wit, the third and fourth digits, the 2 and the 4.

Mr. Green, counsel for American Seating Company, recognized this fact and wrote to Mr. McCall requesting correction [Ex. C, R. 176]. Mr. McCall replied by letter acknowledging the error [R. 172]. In this letter a further obvious typographical error appears and the sum is given at $6,356.00 for no apparent reason. In presenting the matter of this correction to the court at the trial, Mr. Green commenced to read the corrections into the record and correctly states [R. 115]:

> "Where it shows $61.37 at line 12, it should be $6,124.37."

There being no objection to this, the clerk apparently interlineated the correction [R. 18].

Mr. Green then commenced to state his own conclusions as to the further content of Mr. McCall's letter to which Mr. McCall objected. Mr. McCall then suggested that both letters be introduced as evidence and this procedure was agreed upon. Whereupon Mr. Green perceived that Mr. McCall's typographical error might be considered to be an admission, and thereupon, with leave of court granted, amended the prayer to his complaint by interlineation to state the erroneous figure which appeared in Mr. McCall's letter [R. 118]. Neither Mr. McCall nor Mr. Sturr recognized the significance of Mr. Green's

action [R. 118], There is no support for this figure in the body of the complaint [R. 3-9], in the invoice of American Seating Company [R. 168] or elsewhere in the evidence or agreed statement of facts. Counsel for American Seating Company has incorporated this error into the judgment for an advantage of $231.63.

There are no further facts which appear in the record, but it has been argued as a matter of fact and alleged in the complaint that Grandy, Inc., and Glens Falls knew or should have known that the items supplied by plaintiff's would have to be bought by plaintiff. There was no evidence introduced specifically upon this point. It appears that counsel relies upon the exhibits, all of which have heretofore been mentioned, to establish these contentions [R. 76].

IV.

Questions Involved and the Manner in Which They Are Raised.

All of the questions involved were raised in Points on Which Appellants Intend to Rely on Appeal [R. 178-187]. These Points on Which Appellants Intend to Rely on Appeal are repeated in this brief at Point V under the heading Specification of Error Relied Upon and they are numbered in the same way they are numbered in Points on Which Appellants Intend to Rely on Appeal so that the court in turning to these points as referenced in the following questions may turn to the equivalent numbers under Point V which follows in this listing of questions in this brief.

The Points on Which Appellants Intend to Rely are drawn for the purpose of specifying the error relied upon

and relate separately to the performance bond, to the payment bond and also separately to each appellant. The questions involved are common to a number of the individual points of error. Reference will therefore be made to a number of Points on Which Appellants Intend to Rely under each question involved which in turn contain reference to the Findings and Conclusions.

1. **Was There Either an Express or an Implied Contract Between American Seating Company and Appellants, or Either of Them?**

The contention of appellee that an express or implied contract existed between American Seating Company and appellants, and each of them, does not appear in the complaint, but appears for the first time in argument of counsel for appellee at the trial [R. 129, 141, 142] and it appears in the Findings of Fact, paragraph 6 [R. 39] in vague and uncertain language, to wit:

> "and that there existed a contractual relationship relating to said performance bond and payment bond between plaintiff and defendants E. F. Grandy, Inc. and Glens Falls Indemnity Company, and each of them."

This Finding was objected to and its erroneous nature was one of the grounds alleged in Motion for New Trial [R. 43-55] at Point 1(c) [R. 45-46] and it was raised in Points on Which Appellants Intend to Rely on Appeal as Point 3 [R. 184], 4 [R. 184], 5 [R. 185], 6 [R. 185], 8(A) [R. 186] and 8(B) [R. 187].

For argument concerning this question, see this brief, heading VII-1.

2. **Has the Contractor Obligated Itself to Perform the Contract Obligations of Its Subcontractor by Accepting a Surety Bond as Obligee Thereunder?**

This question is raised by Finding of Fact 6 [R. 39] to the effect that there existed a contractual relationship between appellee and appellants relating to the surety bonds, and by Conclusion of Law I [R. 41]. Appellants argued the point upon Motion for New Trial and it was raised in Points on Which Appellants Intend to Rely on Appeal at Point 1(B) [R. 179], 1(E) [R. 181], 2(A) [R. 181], 2(D) [R. 183] and 6 [R. 185].

For argument concerning this question see this brief, heading VII-2.

3. **Where There Is a Performance Bond and a Separate Payment Bond, Is the Obligation of the Surety on the Performance Bond Void Upon the Performance of the Contract, Even Though the Materialmen Have Not Been Paid?**

This question is raised by the complaint and the respective anwers in every respect wherein appellee relies upon the performance bond for recovery, the Findings of Fact, particularly Finding of Fact 6 [R. 39] and by Points on Which Appellants Intend to Rely on Appeal 1(A) [R. 178], 1(C) [R. 180] and 1(D) [R. 180].

For argument on this question, see this brief, heading VII-3.

4. **If the Parties to a Common Law Payment Bond Intended It Solely as a Protection Against Loss or Damage to the Obligee, Is a Stranger to the Bond Entitled to Recover Against the Surety?**

This question was raised by the complaint and the respective answers, by appellee's interrogatory No. 27 to Grandy, Inc. [R. 22] and by appellee's request for admissions No. 4 [R. 27]; it was an issue at the trial, and is again posed in the Findings of Fact and Conclusions of Law as indicated in Points on Which Appellants Intend to Rely on Appeal 1(E) [R. 181], 2(C) [R. 183], 2(D) [R. 183].

For argument on this question, see this brief, heading VII-4.

5. **On a Bond Conditioned Against Loss or Damage to the Obligee, as Distinguished From a Bond Conditioned Against Liability, Does the Surety Incur Liability Before the Obligee Has Actually Suffered Such Loss or Damage?**

This question is first raised by the complaint and the answers of appellants, was raised at the trial, was set forth in Motion for New Trial [R. 43], and is the subject matter of Points on Which Appellants Intend to Rely on Appeal, Point 2(B) [R. 182].

For argument on this point, see this brief, heading VII-5.

6. **Has the Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.**

This question first arose as a result of Finding of Fact 7 [R. 39] and is raised by appellants by Points on Which Appellants Intend to Rely on Appeal, Point 7 [R. 186].

For argument on this point, see this brief, heading VII-6.

V.

Specification of Error Relied Upon.

(This is a duplication of Points on Which Appellants Intend to Rely, appearing in the record at pages 178 to 188, inclusive.)

1. Judgment Against Appellant Glens Falls Indemnity Company and E. F. Grandy, Inc., or Either of Them, Cannot Be Predicated Upon the Common Law Performance Bond.

A. The performance bond here involved is a common law indemnity bond as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned upon the performance of the subcontract by V. L. Murphy. There is no allegation in the complaint, no evidence was introduced and no Finding of Fact was made to the effect that the obligation of said bond was in full force and virtue at the time of the institution of this action. Therefore, Conclusion of Law I, concluding that appellee is entitled to recover against appellants, is reversible error because said Conclusion and the Judgment are not supported by the pleadings, the evidence or the Findings insofar as said Conclusion and Judgment may be based upon the performance bond.

B. The performance bond cannot be the basis for Judgment against appellant E. F. Grandy, Inc., for the further reason that said E. F. Grandy, Inc., was the obligee thereunder and as such is the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or as-

sumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against appellant E. F. Grandy, Inc., are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the Court erred in granting the same insofar as it may be predicated on said bond.

C. The performance bond is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them for the sole purpose of, and restricted by its terms, to indemnifying the contractor, appellant E. F. Grandy, Inc., against the failure of the subcontractor to fully perform the subcontract. To predicate judgment upon the performance bond against the surety, appellant Glens Falls Indemnity Company, the trial court must affirmatively find that the subcontractor failed to perform the subcontract and that appellant E. F. Grandy, Inc., has been damaged thereby. It was reversible error for the trial court to grant judgment against appellant Glens Falls Indemnity Company because there is no evidence to support a finding that appellant E. F. Grandy, Inc., was

damaged by failure of the subcontractor to perform the subcontract and none was made and Conclusion of Law I is therefore unsupported by the Findings of Fact insofar as said Conclusion of Law is based upon the performance bond.

D. As a matter of law, a common law indemnity bond such as the performance bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore, insofar as Conclusion of Law I and the Judgment for appellee against appellant, or either of them, as surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this bond, the said Conclusion of Law and the Judgment are erroneous because they are against the law.

E. Finding of Facts 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said Performance Bond . . . between plaintiff and the defendants . . . and each of them" is wholly unsupported by the evidence and therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law, because it is unsupported by the Findings of Fact and the evidence and therefore does not support Conclusion of Law I or the Judgment against appellants, or either of them.

2. **Judgment Against Appellants Glens Falls Indemnity Company and E. F. Grandy, Inc., or Either of Them, Cannot Be Predicated Upon the Common Law Payment Bond.**

A. The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned to indemnify said appellant obligee against loss resulting to said appellant obligee by reason of the relationship of contractor and subcontractor. Appellant E. F. Grandy, Inc., was the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or assumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against said appellant are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against Appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the Court erred in granting the same insofar as it may be predicated on said bond.

B. The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a sub-

contract between them and was conditioned to indemnify said appellant obligee against loss resulting to said appellant obligee by reason of the relationship of contractor and subcontractor. To predicate Judgment upon this payment bond against the surety Glens Falls Indemnity Company, the trial court must affirmatively find that appellant E. F. Grandy, Inc. has suffered such loss. There is no evidence in the record and no Finding of Fact or Conclusion of Law to the effect that the claim of appellee against appellant E. F. Grandy, Inc., arose by reason of the relationship of contractor-subcontractor existing between appellants and resulted in a loss to appellant E. F. Grandy, Inc., and Conclusion of Law I is therefore unsupported by the evidence and the Findings of Fact; and the court committed reversible error in granting Judgment against appellant Glens Falls Indemnity Company.

C. As a matter of law, a common law indemnity bond such as the payment bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore insofar as Conclusion of Law I and the Judgment for Appellee against appellants, or either of them, as surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this payment bond, the said Conclusion of Law and Judgment are erroneous because they are against the law.

D. Finding of Fact 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said . . . Payment Bond between plaintiff and the defendants . . . and each of them" is wholly unsupported by the evidence and

therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law because it is unsupported by the Findings of Fact and the evidence and therefore does not support Conclusion of Law I or the Judgment against appellant, or either of them.

3. **Judgment Against Appellant Glens Falls Indemnity Company Cannot Be Predicated Upon a Contractual Relationship Between Appellee American Seating Company and Appellant Glens Falls Indemnity Company.**

There is no allegation in the complaint of either an express or implied contract between appellee and appellant Glens Falls Indemnity Company, no evidence thereof was introduced, and Finding of Fact 6 is inadequate in this respect. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings, and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

4. **Judgment Against Appellant Glens Falls Indemnity Company Cannot Be Predicated Upon a Contractual Relationship Between Appellee American Seating Company and Appellant E. F. Grandy, Inc.**

The performance bond and the payment bond of appellant Glens Falls Indemnity Company related exclusively to the subcontract between V. L. Murphy, the subcontractor, and E. F. Grandy, Inc., the contractor. Any direct contractual relationship whether arising by express agreement or by implication of law between appellee and E. F.

Grandy, Inc., would be outside the scope of either of said bonds. The trial court erred in granting Judgment against appellant Glens Falls Indemnity Company insofar as such Judgment may be based upon a contract between appellee and appellant E. F. Grandy, Inc., because such a contract is outside the scope of the said bonds since it is not the contract with respect to which the contract of indemnity was furnished and Conclusion of Law I and the Judgment are unsupported by the Findings of Fact in this respect.

5. Judgment Against Appellant E. F. Grandy, Inc., Cannot Be Predicated Upon a Contractual Relationship Between Appellee and Appellant E. F. Grandy, Inc.

There is no allegation in the complaint of either an express or implied contract between appellee and appellant E. F. Grandy, Inc., and no evidence thereof was introduced and Finding of Fact 6 is inadequate in this respect, and Finding of Fact 7 reciting that appellant E. F. Grandy, Inc., approved the contract between appellee and V. L. Murphy is unsupported by the evidence. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

6. **The Findings of Fact and Conclusions of Law Are Vague and Indefinite and Inadequate to Disclose the Factual or Legal Basis for the Judgment and Are Inherently Inconsistent Because They Cannot Be Interpreted in Any Manner Which Would Result in Joint Legal Liability of Appellants.**

Liability must be predicated upon the bonds or either of them or upon the existence of an express or implied contract between appellee and appellants or either of them. Under the first alternative appellant E. F. Grandy, Inc., could not be liable because as already noted in points IB and 2A said appellant was the obligee and as such the party to be protected. The bonds created no right in favor of any party against said obligee. Under the second alternative, each party would be liable for his own contract with appellee and such a contract was not the subject matter of either bond and outside of the scope thereof and therefore not affected by the provisions of either of said bonds in any manner. As above pointed out, neither party was obligated to appellee by direct contract either express or implied, but any such contract could affect the contracting party only.

7. **The Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.**

Finding of Fact 7 to the effect that on the 1st day of June, 1949, appellee furnished the goods referred to in the complaint and Finding of Fact 9 that the sum mentioned therein was due and owing to appellee from appellants from and after the 1st day of June, 1949, are both entirely

unsupported by the evidence. It was error for the court to so find and to adopt Conclusion of Law I and grant Judgment, both based upon said Findings.

8. The Findings Are Unsupported by the Evidence in the Following Additional Material Respects:

A. Finding of Fact 6 is unsupported by the evidence to the extent that it is therein found that appellants, or either of them, knew that in order for the subcontractor "V. L. Murphy to carry out this contract, it would be necessary for him to purchase and obtain supplies from plaintiff."

B. Finding of Fact 8 is unsupported by the evidence.

C. Finding of Fact 10 is in error in the following material respects: In every respect wherein it is hereinabove alleged that the Findings are not supported by the evidence the court further erred by not affirmatively finding that the contrary is true since in each instance the correlative allegation of the complaint was denied in the respective answers and appellee had the burden of proof.

VI.

Introduction to Argument.

The two bonds which are involved in this action are common law bonds, both of which were furnished to comply with the terms of the subcontract between Grandy, Inc., and V. L. Murphy. They are not required by statute, and the terms thereof are not governed by statute. They are private contracts. This is fully understood and conceded by appellee [R. 135, 143].

The fact that Grandy, Inc., as prime contractor with the Government, posted a Miller Act bond in reliance upon which appellee might have successfully prosecuted an action for payment is mentioned because if an action under the Miller Act had been successfully prosecuted by American Seating Company, Grandy, Inc., would have suffered loss and damage as a principal upon such Miller Act bond. If Grandy, Inc.'s liability had been the result of V. L. Murphy's default, Glens Falls would in turn have been liable on its payment bond to Grandy, Inc. Loss or damage resulting to Grandy, Inc., from default by V. L. Murphy was the hazard against which Grandy, Inc., sought to protect itself by requiring V. L. Murphy to supply the Glens Falls bonds and the only circumstance which could impose liability upon Glens Falls.

Aside from the documents themselves, the only evidence of intention of the parties is (1) the answer of Grandy, Inc., to appellee's interrogatory No. 27 [R. 22], and to the same effect (2) the answer of Grandy, Inc., to request for admissions No. 4 which we quote in full [R. 27]:

> "Answer: Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc., and no one else, against loss."

While the action is based solely upon contract, counsel for American Seating Company makes an unusual argument which appellants conceive to be entirely outside the scope of the issues, but the trial court did not write a decision and the Findings of Fact and Conclusions of

Law are too vague and indefinite to point to the theory upon which the court found liability. The argument is that Grandy, Inc., prevented V. L. Murphy from paying American Seating Company.

This contention apparently rests entirely upon the fact that in Exhibit 1 [R. 146] Grandy, Inc., suggested a method of financing to V. L. Murphy and that V. L. Murphy availed himself of this suggestion by making an assignment of his subcontract to the Farmers and Merchants Bank of Long Beach, which assignment was recognized by Grandy, Inc., and payments on the contract obligations were made in compliance with this assignment. The fact that the bank subsequently loaned $46,000.00 to V. L. Murphy which sum was ample to pay many times over the total amount owing to appellee, is completely ignored by appellee but adequately disposes of the argument.

The Motion for New Trial [R. 43-55] sets forth in detail the manner in which the Findings are not supported by the evidence and the Conclusions are not supported by the Findings. The Specifications of Error Relied Upon, heading V of this brief, specifically point to the errors of the trial court. One of the errors claimed is that the Findings are too vague and indefinite to disclose the legal foundation for the judgment. The argument following is designed to show that the various theories suggested by the Findings and Conclusions and at the trial are all unsound.

VII.

ARGUMENT.

1. There Was Neither an Express nor an Implied Contract Between American Seating Company and Appellants, or Either of Them.

A. There Was No Privity of Contract Between American Seating Company and Grandy, Inc., and There Was Nothing From Which a Contract Could Be Implied.

(a) There Is No Evidence of an Oral or Written Contract.

There is no allegation in the complaint of either an express or implied contract between American Seating Company and Grandy, Inc., but in Finding of Fact 6 [R. 39], which is a Finding respecting paragraph VI of the complaint, a statement was added "that there existed a contractual relationship relating to" the respective bonds between American Seating Company and both appellants, and each of them. The nature of such a contractual relationship is purely a matter of speculation.

The Finding referred to does not support a concept of an express or implied contract directly between the parties named. Appellants assert that there is no Finding which could support a Judgment based upon a direct contract. However, counsel for appellee argued at the trial that such a contract was established by the evidence and argued the same point at the hearing on Motion for New Trial, even after the Findings were made and entered. As an abundance of caution, we address ourselves to this issue, both from the standpoint that there is no Finding to support the Judgment if based upon such a concept and from the standpoint that the evidence does not establish the fact.

There has been no indication that appellee contends that there was any oral contract between American Seating Company and Grandy, Inc. On the contrary, appellee apparently relies upon the exhibits to prove that there was a contract between Grandy, Inc., and American Seating Company [R. 129]. At the trial [R. 141] counsel for appellee contended that the purchase orders from V. L. Murphy to American Seating Company passed through the hands of Grandy, Inc. As has already been noted in the Statement of Facts, Grandy, Inc., received *copies* only of Exhibits 5, Exhibit 6 and Exhibit 7.

Exhibit 5 was the revised quotation which reached Grandy, Inc., on the same day that Grandy, Inc., received a copy of the purchase order from V. L. Murphy to American Seating Company. Note that the *original* of this purchase order went directly from V. L. Murphy to American Seating Company [R. 81]. Exhibit 6, which is a copy of a letter addressed to V. L. Murphy by American Seating Company, was sent to Mr. Grandy, who was President of Grandy, Inc., in order to keep him advised. No argument need be addressed to the fact that every prime contractor must of necessity keep himself fully advised as to the progress of the work of his subcontractors and that constant attention to the progress of his subcontractors is not only customary, but a vital necessity and an exercise of only reasonable prudence in the contracting business.

Appellants submit that transmittal of a copy of Exhibit 6, a letter explaining the current status of negotiations between the subcontractor, V. L. Murphy, and American Seating Company and the transmittal of Exhibit 5, which is a copy of the revised quotation of American Seating Company, and Exhibit 7, which is a copy

of the purchase order, was in the normal course of business. Transmittal and receipt of these documents in no way indicates contractual liability or intent between Grandy, Inc., and American Seating Company.

Also, in the ordinary and usual course of business, Grandy, Inc., forwarded four *copies* of the purchase order to the Officer-in-Charge of Construction, United States Naval Base, "to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation." [R. 163.] The Officer-in-Charge was not requested to transmit any of these copies to American Seating Company and there is no evidence whatsoever that he did so.

Knowledge on the part of Grandy, Inc., that American Seating Company was furnishing the material has no significance. Subsequent correspondence, such as American Seating Company's letter to Mr. Grandy [Ex. 9, R. 164], advising that certain items of equipment being furnished by American Seating Company were being corrected, and the January 6, 1950, letter [Ex. 11, R. 165-170] are both matters which again indicate vigilance on the part of the prime contractor to perform its duty to see to it that the work was promptly completed. The December 22, 1949, letter [Ex. 10, R. 165] from Grandy, Inc., to the Officer-in-Charge of Construction has no significance because it is not accompanied by identification of the enclosures and is simply a letter of transmittal.

The foregoing documents do not indicate an express contract in writing. There is no indication of an offer and acceptance or a manifestation of mutual assent. The essential ingredients of a contractual relationship are wanting. (See *Restatement, Contracts,* Secs. 19 and 20.) This

is an application of the most general contract principles with no refinement and consequently further citation of authority is unnecessary.

(b) No Contract May Be Implied From the Conduct of the Parties; and Grandy, Inc., Has Paid the Full Subcontract Price and Therefore Has Not Been Unjustly Enriched.

There remains the question of whether or not the contract may be implied in law or in fact. American Seating Company never looked to Grandy, Inc., for payment prior to filing the instant action. The invoice of American Seating Company, copy of which is attached to Exhibit 12 [R. 168] shows, "Sold to: V. L. Murphy, Plumbing and Heating." This was dated March 15, 1950. There is no indication that a copy of this invoice ever went to Grandy, Inc., or to Mr. Grandy, its President. American Seating Company next made demand upon Glens Falls, not upon Grandy, Inc., by letter dated December 1, 1950, which is Exhibit 12 [R. 166] and subsequently brought suit against V. L. Murphy in the Superior Court of Los Angeles County and prosecuted the case to judgment. Grandy, Inc., could have been joined in this action, but was not. The conduct of American Seating Company is such as to indicate that it did not expect payment from Grandy, Inc.

Counsel for appeellee argues that Grandy, Inc., knew that American Seating Company furnished the supplies which are the subject of the suit and neither paid appellee nor took any steps to be sure that V. L. Murphy would pay for the materials [R. 141]. Counsel for appellee says an implied contract is shown by the exhibits [R. 142]. He does not properly quote the evidence in that he states that the evidence is that the purchase order

went from V. L. Murphy through the office of Grandy, Inc., to the Navy and back to American Seating Company, which, as we have seen, is not the case. He also states without support in the evidence that Grandy, Inc., set up the specifications. The record shows that the specifications were supplied by the Government in the prime contract, Exhibit B. See also Exhibt 6 [R. 158] wherein American Seating Company reports that it had prepared drawings and negotiated for approval by the Department of Public Works at the Naval Base before sending copies thereof through channels.

As another element, appellee contends, and the court found, that Grandy, Inc., knew that in order for V. L. Murphy to carry out his contract, it was necessary for him to purchase and obtain supplies and materials from plaintiff [Finding 6, R. 39]. This Finding is entirely unsupported by the evidence. The evidence indicates that Grandy, Inc., knew that V. L. Murphy was purchasing these materials from appellee, but goes no further. For all that appears in the evidence, these supplies could be purchased from any vendor of equipment which would meet the specifications of the Government.

It is also contended that the goods in question were delivered to Grandy, Inc., and received by Grandy, Inc. The materials in question were delivered by American Seating Company to Quality Control Surveillance Laboratory, United States Naval Ammunition and Net Depot [Purchase order of March 15, 1950, R. 168]. At no time did any title or possession or control pass to Grandy, Inc. After delivery of the goods, they were under the custody and control of V. L. Murphy, the subcontractor, and after installation they became a part of the work which was owned by the Government.

To support the implied contract theory appellee points to Finding of Fact 8 [R. 40] that Grandy, Inc., received payment from the United States Government for the materials furnished by the plaintiff. Grandy, Inc., received payment for performance of his prime contract with the Government, which, of course, incidentally and necessarily included all of the labor and materials which went into the contract. Appellant Grandy, Inc., was not unjustly enriched. The full amount of its obligation under the subcontract was paid [R. 31].

B. There Was No Privity of Contract Between American Seating Company and Glens Falls and There Was Nothing From Which a Contract Could Be Implied.

As in the case of Grandy, Inc., there is no fact and no Finding of Fact or Conclusion of Law to support the Judgment if it is based upon the argument of appellee that a direct contract of any kind existed between Glens Falls and American Seating Company whereby Glens Falls promised to pay American Seating Company for the materials furnished to V. L. Murphy.

C. Glens Falls Is Not Surety to Protect Grandy, Inc., From Loss or Damage Resulting From Failure of Grandy, Inc., to Perform Its Own Contract.

The undeniable and persistent error of the Judgment and Conclusion of Law I is that appellants have been found liable to appellee jointly. This is to say that both appellants are liable to the same extent on the same obligation. It seems quite apparent to appellants that joint liability cannot be found because of an express or implied contract between American Seating Company and Grandy, Inc., unless Glens Falls was also a party to the

express contract or the implied obligation. No more can be said but that there is no evidence of any joint contract.

Glens Falls is in no way associated with Grandy, Inc., except as surety on the bonds in question. These bonds related to the subcontract only and not to any direct contract between Grandy, Inc., and American Seating Company. They were furnished to protect Grandy, Inc., against loss or damage which might fall upon Grandy, Inc., because of some act or omission of V. L. Murphy, the subcontractor.

Under these circumstances, there are three possible alternative methods of liability of either Glens Falls or Grandy, Inc., but not of both, as follows:

(1) Liability of Grandy, Inc., by virtue of an express or implied promise to pay American Seating Company.

(2) Liability of Glens Falls by virtue of an express or implied promise to pay American Seating Company.

(3) Liability of Glens Falls on its surety bond.

Each of these possible methods of liability is mutually exclusive of the other. The only basis advanced to impose liability on Grandy, Inc., is that it promised American Seating Company to pay for the equipment in question. Under such circumstances, a joint judgment against both appellants is manifest error.

2. **By Accepting a Common Law Surety Bond as Obligee Thereunder, the Prime Contractor, Grandy, Inc., Has Not Obligated Itself to Perform the Contract Obligations of Its Subcontractor.**

It is an elementary principle of the law of suretyship that the obligee of a common law surety bond, including a payment bond, is not liable thereon to a stranger to the bond for the reason that the obligation of the bond runs to and in favor of and for the benefit and protection of, and not against, the obligee of the bond, irrespective of the right, if any, of the stranger to recover from the principal or surety under the bond.

50 *Am. Jur.,* Suretyship, Secs. 2 and 3, pp. 903-905;

Restatement, Security, Sec. 82, p. 228.

Finding of Fact 6 [R. 39] to the effect that there existed a contractual relationship relating to the bonds between appellee and Grandy, Inc., is erroneous, both as a matter of fact and as a matter of law. The obligee is the beneficiary and not one who is obligated in the three-cornered relationship of obligor, surety and obligee.

The error of granting a joint judgment is again inescapable. If any of the three parties to the contractual relationship of suretyship is liable to American Seating Company because of that relationship, the obligee is not. Even if the obligee in some other capacity should also be liable to American Seating Company (which appellants assert is not the case), the resulting judgment could not be a joint judgment because the two liabilities do not stem from the same obligation.

3. Where There Is a Performance Bond and a Separate Payment Bond, the Obligation of the Surety on the Performance Bond Is Void Upon the Performance of the Contract, Even Though Materialmen Have Not Been Paid.

In the original subcontract [R. 147] between the subcontractor, V. L. Murphy, and Grandy, Inc., the prime contractor, the only bond required for the protection of Grandy, Inc., was a "performance or completion" bond to be furnished by V. L. Murphy. By subsequent oral agreement, however, it was agreed between said parties that V. L. Murphy would furnish a performance bond and a payment bond [R. 72-73] instead of the "performance or completion" bond referred to in the subcontract.

The condition of the common law performance bond furnished by V. L. Murphy, as principal, to Grandy, Inc., as obligee, was to the effect that if the principal thereunder should "truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements" of the subcontract between the principal and the obligee, including duly authorized modifications thereof, then said obligation to be void; otherwise, to remain in full force and virtue [Ex. 3, R. 153].

The payment bond furnished by V. L. Murphy, as principal, to Grandy, Inc., as obligee, undertook to hold said obligee

> "free and harmless from and against *all loss and damage* by reason of the failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in subcontract" [Ex. 4, R. 155]. (Emphasis added.)

Where only one surety bond is supplied with reference to a contract or subcontract which requires furnishing materials or labor, the courts have held that the faithful performance of such a contract contemplates payment for the materials or labor and that the surety has obligated itself therefor.

> *Pacific States Co. v. U. S. Fidelity & G. Co.* (1930), 109 Cal. App. 691, 293 Pac. 812.

As stated in *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387, which cited the *Pacific States* case, the question for the court to decide is: Was the bond a contract expressly made for the benefit of the person seeking to recover under it? The answer to this question depends upon the intent of the parties to the bond. The court quotes with approval the test laid down in other cases cited:

> " 'If it can be fairly said from either the contract or the bond, which are to be construed together, that the parties intended to and did agree to pay such third person, a suit could be brought on such bond by such third person to recover upon the promise so made for his benefit.' "

The court then found that the materialman could not recover upon the bond because it was not intended that the surety should be bound for such payment.

In the *Pacific States* case recovery was allowed. In the *Crane Co.* case recovery was not allowed. The intention of the parties governed in both decisions. Both cases involved but a single bond. The case at bar is to be distinguished from the last two cited cases because the parties have provided two common law bonds, a performance bond and a payment bond. But the question before the court is the same: Was the bond in question

a contract expressly made for the benefit of the person seeking to recover under it?

The parties have provided for the contingency of failure of the subcontractor to pay for the materials. The element of "payment" has been segregated from the "performance" contemplated by the parties under the performance bond and dealt with separately in the payment bond. The performance bond, under such circumstances, is clearly designed to provide the obligee with protection with respect to matters of performance other than the matter of payment for materials. Having varied the requirements of the subcontract by substituting two bonds for one, the parties must have intended this action to have some significance and for each to serve a separate function.

Each must be considered and neither ignored. Both must be deemed to have a purpose. *The intention to supply a payment feature which is implied in a surety bond in instances where there is only one bond is expressly negated when the parties have provided a separate bond for this express purpose.*

Attention is invited to *Lamson Co. Inc. v. Jones* (1933), 134 Cal. App. 89, 24 P. 2d 845. In this case there were two bonds posted: (a) a performance bond and (b) a payment bond. The latter was required by statute. The plaintiff failed to avail himself of the payment bond by allowing the statute of limitations to run against bringing suit on this bond. The plaintiff then sought to recover upon the common law performance bond arguing that performance of the contract contemplated payment for materials used. The court refused recovery, saying at 134 Cal. App. 91:

"Appellant urges that it has a right of action on the faithful performance bond exacted of the contractor under the contract and which was also furnished by respondent. Such bond runs to the city of Glendale only, and there is no provision therein which runs to the benefit of labor or materialmen. It is well settled that where a separate bond has been filed complying with the statute and inuring to the benefit of laborers and materialmen, no recovery can be had by a laborer or materialman upon the faithful performance bond executed in connection with the same contract which does not by its terms inure to his benefit. (*Maryland Casualty Co. v. Shafer,* 57 Cal. App. 580, 208 Pac. 192; *Summerbell v. Weller,* 110 Cal. App. 406, 294 Pac. 414.)"

It is an acknowledged fact that the work of V. L. Murphy under the subcontract was completed and accepted by the Government [R. 31, 96]. At this point the obligation of the performance bond was void according to the condition of the bond. The complaint fails to state a claim upon which a judgment may be based as to the performance bond because it contains no allegation that the said bond was of force and virtue. No evidence, Finding or Conclusion appears in support of a judgment based upon this bond and appellants respectfully submit that this fact indicates that the Judgment is not intended to be based thereon.

Perhaps it would be well to observe that the segregation of the payment feature into a separate payment bond manifests the intention of the parties that the performance bond shall not be a contract for the benefit of appellee to satisfy its claim for payment. We now turn to a consideration of the intention of the parties with respect to the payment bond.

4. **American Seating Company Was a Stranger to the Common Law Payment Bond and Is Therefore Not Entitled to Recover Against the Surety Because at the Time the Bond Was Executed the Parties Thereto Intended It Solely as a Protection Against Loss or Damage to the Obligee, Grandy, Inc.**

As pointed out in the last section of this brief, section 5 under heading VII, the intention of the parties to a surety bond is the determining factor where the court is faced with the problem of determining whether a person who furnished materials to a subcontractor is entitled to sue and recover upon a bond furnished to the prime contractor.

> *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387;
>
> *Lamson Co. Inc. v. Jones* (1933), 134 Cal. App. 89, 24 P. 2d 845.

In giving consideration to the persons who are intended to be benefited by the provisions of a payment bond, care must be taken to distinguish the multitude of cases which involve payment bonds required by statute. The terms and provisions of the bonds required by statute are those required by law regardless of the provisions of the bond or the intention of the parties as expressed in the bond or accompanying instruments, but common law surety bonds are to be construed according to their terms. See *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387, from which we quote:

> " 'It is elementary that: "Sureties are never bound beyond the strict letter of their contract; that they have the right to stand upon the precise terms of their agreement, and that there is no authority for

> extending their liability beyond the stipulation to which they have chosen to bind themselves." Callan v. Empire State Surety Co., 20 Cal. App. 483, 485, 129 P. 978, 981.' W. P. Fuller & Co. v. Alturas School District, 28 Cal. App. 609, 612, 153 P. 743, 745."

The intention of the parties may be ascertained from the record at several places: First in point of time, from the subcontract [R. 147], the principal portion of which concerns the protection of the contractor against various forms of loss or damage. We invite the court's attention to the regular and persistent use of the words, "indemnify and save harmless." Specifically, the contractor has sought to protect himself against liens, stop notices, attachments, garnishments, executions, liability for injury to the public, property damage, injury to workmen, damages resulting from unauthorized use of patents, patent infringement, delay in performance, loss, injury or damages to the building, earthquakes and lack of harmony of employees of subcontractor with employees of contractor [R. 149-151]. It appears from the subcontract that the concern of the contractor is his own protection.

The second element of intention in point of time is the fact that the subcontractor and contractor agreed to provide and accept respectively two bonds, a performance bond and a payment bond, thus intentionally segregating the matter of payment for materials from the elements of performance of the contract. The payment bond having been accepted by the contractor, the terms thereof were obviously satisfactory to him. It might also be pertinent to observe that the custom of segregating the features of performance and payment into two bonds is a well recognized practice authorized by the Miller Act

and a frequent practice in all fields of construction work as the cases in the books indicate. This practice is no doubt attributable to the greater flexibility made possible by segregating these two elements.

The only direct evidence of intention appears in the record in two places: First, in the interrogatories to appellant Grandy, Inc., by appellee wherein appellee asked and appellant Grandy, Inc., answered, at interrogatory No. 27 [R. 22]:

> "27. What was your purpose in requiring V. L. Murphy to furnish you with a bond in the sum of $8,833.58?
>
> Answer: For protection in the event of loss to me."

And again in answer to appellee's request for admissions No. 4, directed to Grandy, Inc., wherein appellant Grandy, Inc., was asked to admit and answer as follows [R. 27]:

> "4. That the purpose of requiring V. L. Murphy to furnish the payment bond referred to in plaintiff's complaint was obtained for the purpose of protecting the defendant, E. F. Grandy, Inc., and any suppliers and material man from any loss due to the failure of V. L. Murphy to pay such material man or suppliers.
>
> Answer: Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc., and no one else, against loss."

Grandy, Inc., was interested in protecting itself against the threat of loss as a consequence of the Miller Act. The Miller Act was designed to protect the appellee. Grandy, Inc., had no reason even to be concerned about appellee; and particularly in the light of the protection furnished by the Miller Act, Grandy, Inc., had neither moral nor

legal obligation to seek a bond for the protection of appellee. Should Grandy, Inc., have anticipated that appellee would neglect its rights under the Miller Act? Certainly not! Quite to the contrary, Grandy, Inc., had real reason to expect that as a consequence of the Miller Act, Grandy, Inc., might be compelled to pay a subcontractor's supplier after paying the subcontractor, and Grandy, Inc.'s natural concern would be to protect itself. This explains the character of the bond and the intention of the parties as hereinabove disclosed by the record.

In answer to the test question posed in *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387: "Was the payment bond a contract expressly made for the benefit of appellee?", the record says, no.

Based upon the foregoing discussion in this section and Section 3 preceding it, appellants submit that Finding of Fact 6 [R. 39]:

> "That it is true as alleged in said paragraph that said performance bond and payment bond were written in part for the protection of plaintiff to the extent of plaintiff's claim as made in said Complaint and that there existed a contractual relationship relating to said Performance Bond and Payment Bond between plaintiff and the defendants, E. F. Grandy, Inc., and Glens Falls Indemnity Company, and each of them"

is wholly unsupported by the evidence and, therefore, erroneous, and that as a Conclusion of Law, if the same be so construed, it is likewise erroneous.

5. A Surety Incurs No Liability on a Bond Conditioned Against Loss or Damage to the Obligee, as Distinguished From a Bond Conditioned Against Liability, Until the Obligee Has Actually Suffered Such Loss or Damage.

The distinction between the function of a performance bond and a payment bond when both have been furnished, has already been pointed out. Appellants have also pointed out that the contract has been fully completed within the meaning of the performance bond and that the obligation thereof is therefore void. And in the heading V-4, the point was made that only those who are intended to be benefited by the terms of the bond may sue thereon.

Reflecting the intention of the parties is the manner in which the bond is conditioned. A bond conditioned upon loss or damage to the obligee indicates an intention to restrict its protection to the obligee only. But the manner in which the bond is conditioned has further legal significance. It is well established that suit will not lie against a surety upon such a bond until the loss or damage contemplated has been sustained.

It is unnecessary to consider, in the instant case, whether the procedure of the Federal system will permit cutting across successive steps of the legal process to make the surety on the subcontractor's bond to the prime contractor liable in an action brought by a creditor of the subcontractor who has the unquestioned right to recover against the obligee of such subcontractor's bond as principal under a Miller Act bond. As heretofore pointed out, there is no theory upon which appellee may recover against Grandy, Inc., on a claim arising out of the act or omission of his subcontractor. At least, none has been even suggested.

If suit had been brought under the Miller Act, based upon V. L. Murphy's failure to pay, American Seating Company could have recovered against Grandy, Inc., without question. We conceive that the payment bond was required by Grandy, Inc., in order to provide a solvent indemnitor in such a circumstance. But American Seating Company has not brought such a suit and it is now too late to do so. The result is that Grandy, Inc., has not and will not suffer loss or damage as the result of the failure of its subcontractor to pay American Seating Company. Therefore, appellants contend that appellee did not and cannot state a cause of action against appellants and that there are no facts in the record which will sustain the Judgment and that there is no Finding of Fact which will support Conclusion of Law I and the Judgment.

Section 2778 of Title XII of the California Civil Code provides rules for interpreting an agreement of indemnity and distinguishes between indemnity against liability and indemnity against claims or demands for damages or costs. As to the latter, Section 2778 provides:

> "In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears:
>
> * * * * * * * *
>
> "2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified *is not entitled to recover without payment thereof;* . . ." (Emphasis added.)

That the law of the State of California is plainly stated in the Civil Code is apparent from the case of *Ramey v.*

Hopkins (1934), 138 Cal. App. 685, 688, 33 P. 2d 433, from which we quote commencing at 138 Cal. App. 688:

> "In 13 California Jurisprudence, page 987, the distinction between a bond against liability and an indemnity contract against loss or damages is clearly enunciated. We quote therefrom: 'The distinction between an undertaking against "liability" and the strict contract of indemnity against "loss" is that between contracting that an event shall not happen, and contracting to indemnify against the consequences of the event if it should happen. A liability is not a damage, according to the signification of that term as employed in contracts of indemnity, and it has been said that courts have no authority to insert the term "liability" in a contract, and then proceed to enforce the contract as they—but not the parties—have made it. A bond indemnifying a person against loss and liability takes effect from its delivery, and its legality is to be determined by reference to the state of things then existing.' And then, on page 991 of the same volume, section 12, the rule is clearly stated that the right of action upon a bond indemnifying against loss or damage accrues only, and at the time when the indemnitee suffers actual loss by being compelled to pay, and the actual payment of damages. The authorities cited in the footnotes so fully support the text which we have quoted that further attempts to distinguish between a bond insuring against liability and one insuring against loss or damages is unnecessary. Nor is it necessary to cite further authorities that before an action can be begun upon a contract of indemnity insuring against loss or damages the damages must have been paid as required by subdivision 2 of section 2778 of the Civil Code." (Emphasis added.)

The *Ramey* case represents the general rule which is recognized and applied in the Federal Courts. (See *United States v. United States Fidelity & Guar. Co.* (C. C. A. 2, 1940), 113 F. 2d 888.)

As already pointed out, the obligee of the payment bond in the case at bar has not suffered loss or damage (payment to appellee being the very loss or damage contemplated); moreover, there is no theory upon which the loss or damage referred to in the bond can legally fall upon him.

6. The Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.

Finding of Fact 9 [R. 40] states that the sum awarded in the Judgment has been due and owing from June 1, 1949. Conclusion of Law I states that interest is due from said date and the Judgment so provides.

On June 1, 1949, there was no contract for the purchase of the equipment. American Seating Company's quotation [R. 156], addressed "To All Contractors," was not even dated until August 22, 1949. On August 23, 1949, there was still no firm decision to purchase and install the equipment. The equipment was still on the drawing board. See Exhibit 6 [R. 158]. The purchase order wasn't sent to American Seating Company until at least September 23, 1949, the date it bears [Ex. 8, R. 163].

The date of delivery of the equipment does not appear. As already pointed out, the record discloses no demand made against Grandy, Inc., prior to institution of this action and demand was first made against Glens Falls by letter dated December 1, 1950 [Ex. 12, R. 166]. The invoice to the real purchaser, V. L. Murphy, was dated March 15, 1950.

In short, there is no evidence which will sustain the granting of interest from June 1, 1949, and none which will sustain any award of interest prior to Judgment.

Conclusion.

As in many cases which come before the courts, there is no solution to this case which could be considered a happy ending. American Seating Company is simply asking that its credit loss on a sale to V. L. Murphy, who is insolvent, be passed on to someone else. It is true that American Seating Company is forced to innocently stand a loss, but it is asking the court to make equally innocent parties suffer the loss instead. Appellants respectfully represent that by reason of the errors designated in the Specification of Error Relied Upon and the arguments relating thereto, which hereinabove appear, Judgment should be reversed with instructions to enter Judgment for appellants.

Respectfully submitted,

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By Albert Lee Stephens, Jr.,

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